

Audit Committee Meeting	Agenda Item: X
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Meeting Date	25 May 2011
Report Title	Implementation of International Financial Reporting Standards (IFRS)
Portfolio Holder	Councillor Dewar-Whalley – Executive Member for Finance and Budget Management
SMT Lead	Nick Vickers – Interim Head of Finance
Head of Service	Nick Vickers – Interim Head of Finance
Lead Officer	Phil Wilson – Chief Accountant
Key Decision	No
Classification	Open
Forward Plan	Reference number:

Recommendations	<ol style="list-style-type: none"> 1. Note the report. 2. Approve the documents setting out the core financial statements as amended to comply with the IFRS reporting requirements, (Appendix I).
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1. Purpose of Report and Executive Summary

- 1.1 The effective commencement of International Financial Reporting Standards (IFRS) is as at 1 April 2010 and the purpose of this report is to:
 - 1.1.1 update Members on the issues addressed in the preparation towards adoption of IFRS for the financial year 2010-11;
 - 1.1.2 present draft Core Financial Statements in IFRS format for approval.

2. Background

- 2.1 The change to IFRS is intended to enable easier comparison of the Council's financial position with the private sector both within the UK and overseas. There have been changes in the format of the Council's accounts over the last few years that have acted as a precursor to the full change to IFRS. Members have received reports on 27 May 2009 and 15 December 2010 outlining an overview of the anticipated implications arising from the introduction of IFRS and progress towards achieving this goal.
- 2.2 The introduction of IFRS requires a change from preparing the accounts using the traditional UK Generally Accepted Accounting Practice (GAAP) to IFRS and all local authorities are required to present their annual Statement of Accounts using the new standards for the 2010-11 financial year and beyond. The content and format of the UK GAAP accounts were specified and regulated by a Chartered Institute of Public Finance and Accountancy (CIPFA) document, the Statement of Recommended Practice, (SORP 2009). The IFRS format accounts are subject to

similar guidance issued by CIPFA, “the Code of Practice on Local Authority Accounting”, (the Code).

- 2.3 The main issues which arise from the adoption of IFRS accounting are related to treatment of grants, fixed asset and component accounting, the treatment of leases, group accounts, employee benefits and some significant changes to accounting policies and supporting statements and notes to the accounts.

3. Progress to date

Restated Statements and Key Issues

- 3.1 The 2009-10 Statement of Accounts comprised several core financial statements and these are being replaced and or amalgamated into four new core financial statements as shown below:

SORP Code 2009/10		IFRS Code 2010/11	
Income and Expenditure Account	→	Comprehensive Income and Expenditure Account	
Statement of Recognised Gains and Losses	→		
Statement of Movement on the General Fund Balance	→	Movement in Reserves Statement	
Balance Sheet	→	Balance Sheet	
Cash Flow Statement	→	Cash Flow Statement	

- 3.2 Attached at Appendix I are financial statements in both the old and new formats for comparative purposes showing how they reconcile to each other. As can be seen they are very similar in format - what differs are the accounting changes required under IFRS.
- 3.3 Ultimately, the adjustments made to the 2009-10 accounts to comply with IFRS are subject to approval by the external auditors. Consequently, a review of the restated accounts for 2009-10 was carried out by the Audit Commission during March 2011 and their questions and comments have been answered and any changes have now been reflected in the core statements shown in appendix I.
- 3.4 The financial statements have been amended as a result of the review of the following issues.
- **Grants and External Contributions** – The IFRS Code requires that any external contributions be recognised in the Comprehensive Income and Expenditure account in the year in which they are received. Previously external grants and contributions had been credited to services over the life of the asset. IFRS therefore requires adjustments to 2009-10 service costs to remove any income received from the deferred grant account.

The second change in respect of grants is to show the total of any grants received during the financial year in the Comprehensive Income and Expenditure account. Any sums not used to fund capital works are taken to reserves by transfer through the Movement in Reserves statement.

- **Fixed Assets and Component Accounting** – The IFRS Code requires a review of the classification of assets within the asset register. The Council has carried out this review and a number of assets have been moved to the category of “Property, Plant and Equipment” from the “Investment” and “Surplus Asset” classifications. These assets are now required to be depreciated in line with the Council’s accounting policies. Any new depreciation charges will increase the net cost of services but will be reversed out as a transfer to the Movement in Reserves statement so having no impact on the overall level of General Fund balances. The IFRS Code requires that where an asset has major components with different estimated useful lives, these are depreciated separately. This is known as “componentisation” and whilst there were no components identified for 2009-10, the Council has prepared a policy for 2010-11.
- **Fixed Assets - Investment Properties** – The IFRS Code provides a more limited definition of investment properties than has been applied previously. The Code also requires that the expenditure and income on these properties be shown within the specific service headings. There is no impact on the overall core financial statements as a result of this change.
- **Leases** - The Council is required to identify assets within “normal” service contracts where it has a significant/exclusive use of the asset even where the asset in question is owned by the contractor for the provision of the service. The Council has identified two contracts where this applies, i.e. for Grounds Maintenance and for Cleansing services. In both cases the assets used are vehicles and plant and the accounting treatment of these is that they are Finance Leases. The IFRS requirement is that the Council shall therefore show the value of these assets and their corresponding lease liabilities on its balance sheet and reflect any capital and financing charges in the main core accounts. The accounting adjustment requires the Council to identify the principal and interest charges relating to the notional lease payment and account for the interest charge not as a cost of service but as a financing and investment cost within the Comprehensive Income and Expenditure account. In short, this means for example that under IFRS, the refuse freighters used by Verdant have to be in the Council’s accounts.
- **Group Accounts** - The Code broadens the definition of an interest in a company/entity to include “an ability to exert a significant influence”. If the Council has such an interest then accounts have to be separately prepared for that entity. Having undertaken a review of all potential subsidiaries, associates, and joint ventures against the above criteria, it has been determined that the production of group accounts are not necessary in relation to 2009-10.
- **Employee Benefits** – This refers to benefits that employees receive as part of their contract of employment, that are due but which have not been taken at the balance sheet date, the most common of these is holiday pay. Under the Code, the cost of providing holidays and similar benefits is required to be recognised in the financial year in which entitlement is earned. As a result the authority is now required to accrue for any annual leave earned but not taken at 31 March each year. Under the previous accounting arrangements no such accrual was required. The balance at each balance sheet date is transferred to an Accumulated Absences Account so there is no impact on the net cost of services.

Progress on Action Plan

- 3.5 A detailed action plan for the implementation of IFRS was prepared. The work in preparing the restated core statements and supporting documentation has addressed the tasks on this plan.
- 3.6 However, although the above tasks have been completed the effective commencement date for IFRS is 1 April 2010 and officers are continuing to prepare for the preparation of the Statement of Accounts for 2010-11 under the IFRS regulations. The main tasks still to be considered are as follows.
- **General** – The change to IFRS is not just a finance issue and may affect all services and the implications of the adoption of IFRS will be a consideration to many aspects of the Council's business. All relevant officers need to be updated/ trained on the implications of IFRS and all sources of required information need to be checked to ensure that data can be accessed and used efficiently and effectively within the new reporting regime.
 - **Asset Register** – The Code has made changes to classifications of the Council's assets. All relevant staff are aware of the change in requirement and the asset register has been reviewed as part of the process towards preparing the 2010-11 financial statements.
 - **Leasing** – The IFRS Code has changed the accounting treatment of leases which at this time has not affected the Council's current arrangements. This change in interpretation has been communicated to all staff who prepare leases to ensure that the Council does not enter into new arrangements that may adversely affect its finances.
 - **Accounting Policies** – The Council's accounting policies set out the technical methodologies for accounting for a wide variety of issues within its accounts. The accounting policies have been reviewed and amended where necessary to reflect the changes arising from IFRS.
 - **Operating Policies/Guidance** – When preparing the draft restated accounts for 2009-10 it has been necessary/helpful to document criteria that can be applied either generically or specifically to certain tasks. The Strategic Management Team (SMT) has approved changes to operational procedures to facilitate preparation of the Statement of Accounts for 2010-11 and future years.
- 3.7 The Department for Communities and Local Government has recently issued a proposed change to the Accounting and Audit Regulations which states that local authorities no longer need to have member approval of the accounts before 30 June "so that the bodies will have additional time, perhaps one or two weeks, to prepare their accounts. As the larger bodies will be moving to accounts based on International Financial Reporting Standards for 2010-11 this additional time should assist them in planning and carrying through the preparation process". The accounts will have to be signed by the Head of Finance by 30 June. The 2010-11 Statement of Accounts will be submitted for approval to the Audit Committee on 28 September at the same meeting with the report from the Audit Commission on the accounts.

- 3.8 The changes described above mostly are technical accounting amendments required in order to meet the new IFRS standards. However, there are some issues arising from the implementation of IFRS that could potentially impact on the Council's budget. For example, rent income from leased properties. If the Council's leases for the industrial units were redefined as "finance leases" according to IFRS, then instead of the lease income being revenue as at present, the income would have to be split between interest (revenue) and principal, with the latter going not to revenue but to capital receipts. Property are reviewing their leases to determine if this could affect the nature of any lease given in the future.
- 3.9 However, this issue will only impact on leases agreed after 1 April 2010, and therefore it is essential that the relevant departments consult with Finance before agreeing new leases after this date, as there could be IFRS related budget implications.
- 3.10 The move towards IFRS represents a big change for local authority accounting with the introduction of a new code of practice with the added complication of full retrospection where changes need to be made (e.g. embedded leases). The Finance Department has responded by attending courses, obtaining full technical guidance, retaining the services of a consultant who has successfully implemented IFRS elsewhere and by Chairing meetings of the Kent IFRS Chief Accountants Project Group whose aim is to gain mutual understanding of the implications of IFRS, gain a consistent Kent wide approach and raise potential contentious issues with the experts at the Audit Commission at an early stage to improve the preparation of the 2010-11 accounts.

Next Steps

- 3.11 The restatement of the 2009-10 core financial statements has now been completed and the auditors have commented that: "In respect of IFRS, I can confirm that there are no areas of concern/issues arising from the restatement exercise and that the Council has made very good progress to date."
- 3.12 The restatement work has required some minor changes to accounting procedures that will be applied for 2010-11 and future years.

4. Alternative Options

- 4.1 The implementation of IFRS is a statutory requirement.

5. Consultation Undertaken or Proposed

- 5.1 No consultation has been necessary in the development of these proposals.

6. Implications

Issue	Implications
Corporate Plan	Delivering a good timely Statement of Accounts to IFRS standards is important for the Council's priority to become a High Performing Organisation.

Issue	Implications
Financial, Resource and Property	The implementation of IFRS requires input from Finance and Property and other service departments as detailed in the report.
Legal and Statutory	The implementation of IFRS is a statutory requirement and has required input from Legal, especially on leases.
Crime and Disorder	The integrity of the accounts is important to ensure the Council performs with transparency and fairness and the accounts can be relied upon.
Risk Management and Health and Safety	None
Equality and Diversity	None
Sustainability	None

7. Appendices

7.1 The following documents are to be published with this report and form part of the report

- Appendix I: Restated Core Financial Statements 2009-10

8. Background Papers

8.1 The background papers are held by Finance and include:

- Code of Practice on Local Authority Accounting 2010-11 based on International Financial Reporting Standards
- Best Value Accounting: Code of Practice 2010-11
- CIPFA Local Authority Accounting Bulletins
- Swale Borough Council Statement of Accounts 2009-10 and 2008-09
- International Financial Reporting Standards Briefing Papers to Audit Committee

INCOME AND EXPENDITURE ACCOUNT

SWALE	SORP	IFRS ADJUSTMENTS							IFRS
	2009/10 Net Expenditure £'000	Amortised Grants £'000	Capital Grants £'000	Embedded Leases £'000	Depreciation £'000	Drainage Board £'000	Investment Property £'000	Annual Leave £'000	2009/10 Net Expenditure £'000
Central Services to the Public	1,424	5			7				1,436
Cultural Services	4,475	132		(15)	1				4,593
Environmental Services	7,125	76		(65)	1				7,137
Planning Services	2,088	3							2,091
Highways etc	280								280
Housing	1,710				1				1,711
Corporate and Democratic Core	2,643								2,643
Non-Distributed Costs	859				48	(324)		(38)	545
Net Cost of Services	20,604	216	0	(80)	58	(324)	0	(38)	20,436
(Gain) / Loss on Disposal of Fixed Assets	(475)								(475)
IFRS Drainage Board Levy						324			324
Precepts paid to Parish Councils	700								700
Contribution of Housing Capital Receipts to Government Pool	10								10
Trading Undertakings	(414)						390		(24)
Interest Payable and Similar Charges	101			80					181
Pensions Interest Cost	4,524								4,524
Expected Return on Pension Assets	(2,098)								(2,098)
Income and Expenditure in Relation to Investment properties							(390)		(390)
Interest and Investment Income	(59)								(59)
Net Operating Expenditure	22,893	216	0	0	58	0	0	(38)	23,129
Income From Council Tax	(8,063)								(8,063)
General External Contributions	(62)								(62)

INCOME AND EXPENDITURE ACCOUNT

SWALE	SORP	IFRS ADJUSTMENTS							IFRS
	2009/10	Amortised	Capital	Embedded	Depreciation	Drainage	Investment	Annual	2009/10
	Net	Grants	Grants	Leases		Board	Property	Leave	Net
	Expenditure	£'000	£'000	£'000	£'000	£'000	£'000	£'000	Expenditure
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
General Government Grants	(3,173)								(3,173)
Capital Grant Contributions			(1,516)						(1,516)
National Non-Domestic Rate Distribution	(9,751)								(9,751)
(SURPLUS) / DEFICIT FOR THE YEAR	1,844	216	(1,516)	0	58	0	0	(38)	564

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES	£'000
IFRS (Surplus) / deficit arising on revaluation of fixed assets	
(Surplus) / Deficit on the General Fund	1,844
Other Adjustments	(5)
Actuarial (Gains) / Losses on Pension Fund Assets & Liabilities	21,380
TOTAL RECOGNISED (GAIN) / LOSS	23,219

IFRS OTHER COMPREHENSIVE INCOME AND EXPENDITURE

17,038

TOTAL COMPREHENSIVE INCOME AND EXPENDITURE

17,602

Amortised Grants - The IFRS code no longer also Government Grants to be written off against the asset over its useful life, therefore the credit incurred in 2009/10 needs to be reversed.

Capital Grants - In line with the amortised grants rather than writing them off they are fully recognised in the year of receipt.

Embedded Leases - The IFRS code requires the calculation and inclusion of lease financial for contractor assets which are used predominately by the authority to provide services. In this case it is for Street Cleansing and Refuse Collection.

Annual Leave - Under the IFRS code we should calculate the monetary values of outstanding leave owed to staff as at the end of the financial year.

	BALANCE SHEET							31 March 2010 Per IFRS £'000
	31 March 2010 Per SORP £'000	IFRS Adjustments 2008-09 £'000	Asset Reclass- ification £'000	Embedded Leases £'000	Capital Cont Deferred £'000	Cash Equivalents £'000	Annual Leave £'000	
Land & Buildings	33,553	(522)	69					33,100
Vehicles, plant and equipment	2,434	(854)	155					1,735
Infrastructure assets	2,960	125	11					3,096
Leased Assets		2,573	(155)	(365)				2,053
Community assets	3,373							3,373
Surplus Assets held for Disposal	2,467	(2,003)	(464)					0
Non Operational Land and Buildings		4,033	(67)					3,966
Property, Plant & Equipment	44,787	3,352	(451)	(365)	0	0	0	47,323
Investment Property	4,985	(2,232)	(63)					2,690
Intangible Assets	75							75
Long Term Investments	4							4
Long Term Debtors	2,115							2,115
Long Term Assets	7,179	(2,232)	(63)	0	0	0	0	4,884
Short Term Investments	724					(724)		0
Stocks & Work in Progress	2							2
Short Term Debtors	12,158							12,158
Assets available for Sale			525					525
Current Assets	12,884	0	525	0	0	(724)	0	12,685
Bank Overdraft	(997)					997		0
Cash and Cash Equivalents						(273)		(273)
Short Term Creditors	(3,467)	(197)					38	(3,626)
Current Liabilities	(4,464)	(197)	0	0	0	724	38	(3,899)
Provisions	(240)							(240)
Capital Contributions Deferred	(7,600)	5,866			1,734			0
Deferred Revenue S106 Receipts	(1,111)							(1,111)

	BALANCE SHEET							31 March 2010 Per IFRS £'000
	31 March 2010 Per SORP £'000	IFRS Adjustments 2008-09 £'000	Asset Reclass- ification £'000	Embedded Leases £'000	Capital Cont Deferred £'000	Cash Equivalents £'000	Annual Leave £'000	
Capital Grants Unapplied	(2,636)							(2,636)
Lease Liability inc Embedded	(1,825)	(1,719)		365				(3,179)
Pension Liability	(55,800)							(55,800)
Long Term Liabilities	(69,212)	4,147	0	365	1,734	0	0	(62,966)
NET ASSETS	(8,826)	5,070	11	0	1,734	0	38	(1,973)
General Fund Balance	2,559							2,559
Earmarked Reserves	6,642							6,642
Capital Receipts	775							775
Deferred Capital Receipts	69							69
Total Usable Reserves	10,045	0	0	0	0	0	0	10,045
Revaluation Reserve	6,049		(185)					5,864
Available-for-Sale Fin Inst Reserve								0
Capital Adjustment Account	30,934	5,266	197		1,734			38,131
Financial Instruments Adj Account	(142)							(142)
Collection Fund Adjustment Account	88							88
Employee Adjustment Account		(197)					38	(159)
Pensions Reserve	(55,800)							(55,800)
Total Unusable Reserves	(18,871)	5,069	12	0	1,734	0	38	(12,018)
NET WORTH	(8,826)	5,069	12	0	1,734	0	38	(1,973)

Investment Property Revaluation to Capital Adjustment Account - Under the IFRS Code all gains and losses on investment property are charged to the Comprehensive Income and Expenditure Account and Reversed to the Capital Adjustment Account. Therefore, all current balances held for Investment Properties within the Revaluation Reserve need to be moved to the Capital Adjustment Account.

Embedded Leases - Under the IFRS code we are required to recognise the value of assets held under embedded leases within the balance sheet, this net book value will be offset by a deferred liability on the balance sheet.

BALANCE SHEET

31 March 2010 Per SORP	IFRS Adjustments 2008-09	Asset Reclass- ification	Embedded Leases	Capital Cont Deferred	Cash Equivalents	Annual Leave	31 March 2010 Per IFRS
£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000

Capital Contributions Deferred - The contributions held against purchased assets and are written down in line with the asset life, the new code recognises these contributions in the year that they arise and therefore require the held on this account to be transferred to the Capital Adjustment Account.

Cash Equivalents - These are internally managed investments which have a maturity of less than 3 months of the balance sheet date.

Annual Leave - The accrued annual leave is shown within the creditors balance and is offset by an employee adjustment account on the lower half of the balance sheet.

IFRS CASH FLOW STATEMENT							
	SORP 2009-10 £'000s	Govt Grants Deferred £'000s	Capital Grants £'000s	Asset Reclass- ification £'000s	Employee Benefits £'000s	Cash Equiv. £'000s	IFRS Restated 2009-10 £'000s
a) Net Surplus or Deficit on the Provision of services	1,844	216	(2,481)	58	(38)		(401)
b) Adjust net surplus or deficit on the provision of services for non-cash movements							
Depreciation	(1,372)			(58)			(1,430)
Impairment and downward valuations	(1,614)						(1,614)
Amortisation	198	(216)					(18)
Increase in impairment provision for bad debts	(215)						(215)
Movement in Creditors	1,032				38		1,070
Movement in Debtors	1,532						1,532
Movement in Stock (Inventories)	0						0
Pension liability	(305)						(305)
Carrying amount of non-current assets sold	(218)						(218)
Other non-cash items charged to the net surplus or deficit on the provision of services	84		2,481				2,565
c) Adjust for items included in the net surplus or deficit on the provision of services that are investing and financing activities							
Proceeds from short term and long term investments	38						38
Proceeds from the sale of property, plant and equipment, investment property and intangible assets	390						390
d) Net Cash Flows from Operating Activities	1,394	0	0	0	0	0	1,394
e) Investing Activities							
Purchase of Property, plant and equipment, investment property and intangible assets	2,134						2,134
Other Payments for investing activities	913						913

IFRS CASH FLOW STATEMENT							
	SORP 2009-10 £'000s	Govt Grants Deferred £'000s	Capital Grants £'000s	Asset Reclass- ification £'000s	Employee Benefits £'000s	Cash Equiv. £'000s	IFRS Restated 2009-10 £'000s
Proceeds from the sale of property, plant and equipment, investment property and intangible assets	(390)						(390)
Net cash flows from investing activities	2,657	0	0	0	0	0	2,657
f) Financing Activities							
Cash receipts of short and long term borrowing							0
Other receipts from financing activities	(1,878)						(1,878)
Repayments of short and long term borrowing	(4,096)					1,386	(2,710)
Other payments for financing activities	3,241						3,241
Net cash flows from financing activities	(2,733)	0	0	0	0	1,386	(1,347)
g) Net increase or decrease in cash or cash equivalents	1,318	0	0	0	0	1,386	2,704
h) Cash and cash equivalents at the beginning of the reporting period	321					2,110	2,431
i) Cash and cash equivalents at the end of the reporting period	(997)					724	(273)

IFRS - MOVEMENT IN RESERVES STATEMENT

	General Fund £'000	Earmarked Gen Fund Reserves £'000	Capital Receipts Reserves £'000	Deferred Receipts £'000	Total Usable Reserves £'000	Unusable Reserves £'000	Total Reserves £'000
BALANCE AT 1 APRIL 2009	1,821	6,639	1,399	87	9,946	5,179	15,125
Comprehensive Income & Expenditure							
Surplus / (Deficit) on Provision of Services	(564)				(564)		(564)
Other Comprehensive Income & Expenditure					0	(17,038)	(17,038)
Total Comprehensive Income & Expenditure	(564)	0	0	0	(564)	(17,038)	(17,602)
Adjustments Between Accounting Basis & Funding Basis Under Regulations							
Depreciation and Impairment of Fixed assets	3,105				3,105	(3,105)	0
Amortisation Adjustments	0				0	1,952	1,952
Pension Costs	305				305	(305)	0
Minimum Revenue Provision	(481)				(481)	481	0
Net Gain / Loss on Sale of Fixed Assets	(475)		388	(18)	(105)	105	0
Financial Instruments Adjustment Account	4				4	(4)	0
Revenue Expenditure Funded by Capital Under Statute (REFCUS) adjustments	496				496	(496)	0
Employee Benefits	(38)				(38)	38	0
Write out of asset value					0	70	70
Capital Grants Applied	(1,516)				(1,516)		(1,516)
Capital Expenditure Charged to the General Fund Balance	(92)				(92)	92	0
Collection Fund Adjustment Account	(12)				(12)	12	0
Transfer from Capital Receipts Reserves to Fund Payment to the Housing Capital Receipts Pool	10		(10)		0	0	0
Transfer from Capital Receipts Reserves to Fund Purchase of Fixed Assets			(1,005)		(1,005)	1,005	0
Net Increase / (Decrease) Before Transfers to / from Earmarked Reserves	742	0	(627)	(18)	97	(17,193)	(17,096)
Transfers to / from Earmarked Reserves							
Earmarked Reserves	(4)	4			0		0
Increase / (Decrease) in Year	738	4	(627)	(18)	97	(17,193)	(17,096)
BALANCE AT 31 MARCH 2010	2,559	6,643	772	69	10,043	(12,014)	(1,971)